HR REIT

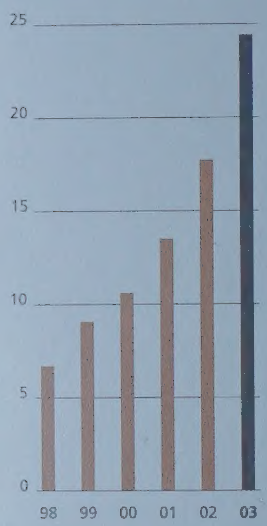
STABILITY THROUGH DISCIPLINE

2003 ANNUAL REPORT

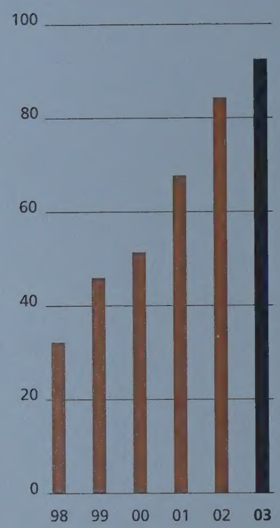
OVERVIEW

Through a series of profitable acquisitions spanning the past seven years, H&R REIT has steadily increased its leasable area, cash distributions to unitholders and stock market capitalization. The sources of H&R's income are broadly diversified by type of asset and geographic region.

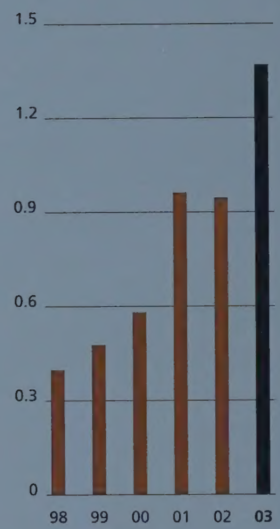
HIGHLIGHTS



Leasable Area
(square feet, millions)



Distributions to Unitholders
($ millions)



Market Capitalization
($ billions, year end)

PROFILE

Incorporated in 1996, H&R Real Estate Investment Trust owns and manages a portfolio of income-producing properties and provides mezzanine financing for development projects. As a closed-end REIT, a substantial portion of H&R's cash is distributed to unitholders each month and much of it is tax deferred. Our internal management conducts day-to-day operations under the direction of a Board of Trustees, and investment opportunities are subject to specific guidelines and approval of the Trustees. Units of the Trust trade on the Toronto Stock Exchange (symbol: HR.UN).

PRIMARY OBJECTIVES

H&R REIT pursues two primary objectives: to provide unitholders with reliable and growing cash distributions from its portfolio of income-producing properties, and to increase the value of units through active management of H&R's assets, accretive acquisition of additional properties, and funding of new developments in which the REIT holds a purchase option. We are committed to maximizing cash distributions and capital appreciation for unitholders while maintaining prudent risk management and conservative use of financial leverage.

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STABILITY THROUGH DISCIPLINE

OCCUPANCY RATE

99%

H&R'S STRONG, DIVERSIFIED PORTFOLIO OF WELL-LOCATED PROPERTIES, LEASED TO HIGHLY CREDITWORTHY TENANTS, PRODUCES STEADILY INCREASING CASH FLOW. THE PORTFOLIO'S AVERAGE OCCUPANCY RATE OVER THE PAST SIX YEARS OF 99% HAS BEEN EXCEPTIONALLY HIGH COMPARED TO THE REST OF THE CANADIAN COMMERCIAL REAL ESTATE SECTOR AND IS TESTAMENT TO THE HIGH QUALITY OF THE PORTFOLIO.

12

YEARS AVERAGE TERM TO MATURITY

H&R EXECUTES A DISCIPLINED GROWTH STRATEGY OF MATCHING LONG-TERM LEASES WITH LONG-TERM MORTGAGES, CARRYING OUT ACCRETIVE ACQUISITIONS AND PROVIDING MEZZANINE FINANCING FOR SELECTIVE NEW DEVELOPMENTS IN WHICH IT HOLDS AN OPTION TO PURCHASE UPON COMPLETION. THE AVERAGE TERM TO MATURITY FOR H&R'S LEASES AND MORTGAGES IS APPROXIMATELY 12 YEARS.

DISCIPLINED FINANCIAL MANAGEMENT LEADS TO H&R'S STELLAR RETURNS, SOLID BALANCE SHEET AND ACCESS TO AFFORDABLE CAPITAL THAT FUELS ITS GROWTH. IN 2003, THE REIT MANAGED TO GENERATE AN AVERAGE LEVERED RETURN ON INVESTMENT IN ACQUISITIONS IN EXCESS OF 13%. AND AFTER RAISING OVER $200 MILLION IN EQUITY, H&R'S YEAR-END RATIO OF DEBT TO GROSS BOOK VALUE STOOD AT 61%.

13%

AVERAGE LEVERED ROI

TELUS TOWER

Location: Downtown Calgary, Alberta
Rentable area: 705,000 square feet, Class A office tower
Highlights: H&R has acquired a 50% interest in this office property for $68 million and generated a 13% levered return. The 28-storey building is fully leased, mostly to TELUS Communications until 2016 and to the provincial government.

PRESIDENT'S MESSAGE

BY ALMOST EVERY MEASURE OF OPERATING AND FINANCIAL PERFORMANCE, 2003 WAS AN EXCELLENT YEAR FOR H&R REIT UNITHOLDERS, AND WE HAVE THE FOUNDATION TO BUILD ON THIS SUCCESS IN 2004 AND BEYOND.

2003 HIGHLIGHTS

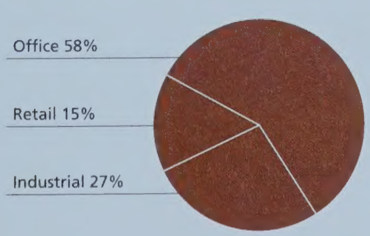
More than most other income trusts, H&R Real Estate Investment Trust has a relatively long, established history of delivering stable performance and building value through disciplined investments. Today, H&R is the second largest and most diversified REIT in Canada, and its profits are growing at a steady pace.

The numbers are telling. Last year, H&R purchased a total of $670 million of properties in Canada and the United States. The REIT acquired 14 office, retail and industrial properties from Montreal to Edmonton, and 34 properties from Connecticut to Florida. All the while, we maintained the portfolio's overall occupancy rate – a key operating benchmark in the commercial real estate business – at an enviable 99%. As a result of the accretive acquisitions, the REIT's assets grew 31% to $2.7 billion, and additionally factoring in contractual rent escalations, revenue rose 13% to $334 million. Consequently, we increased net earnings 8% to $91 million (or $1.21 per unit), while distributable income grew 11% to $109 million ($1.45 per unit).

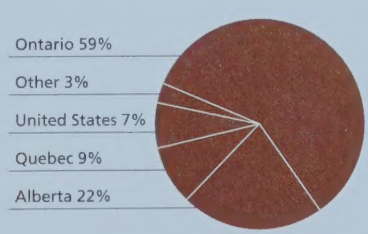
PORTFOLIO QUALITY AND DIVERSIFICATION

Through thoughtful and timely acquisitions and dispositions, we have improved the quality of the H&R portfolio. And by our acquiring relatively new properties, the average age of our portfolio is 12 years, reducing the amount of capital expenditures required to maintain the properties.

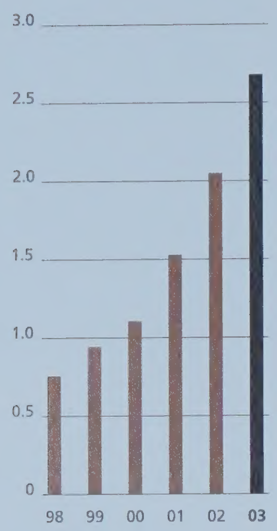
We have also enhanced the quality and reliability of H&R's distributable income – further diversifying the portfolio by both asset type and geographic region. In 2003, we increased the share of operating income from industrial and retail properties to 42% for the year from 40% a year earlier and the income from the United States to 7% from 1%. The bulk of our income (81%), however, is still derived from the strong and diversified economies of Ontario and Alberta.



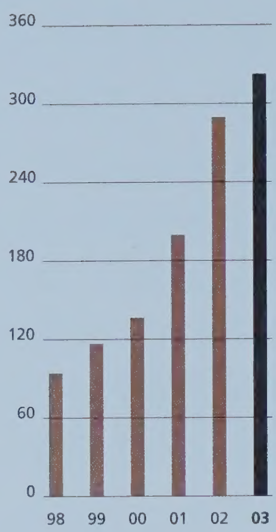
Net Operating Income by Type of Asset
for the year ended December 31, 2003



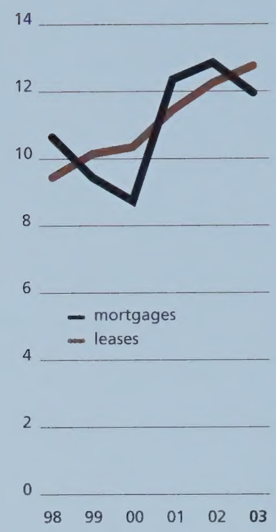
Net Operating Income by Geographic Region
for the year ended December 31, 2003



Assets
($ billions)



Rentals from
income properties
($ millions)



Average term to maturity
(years)

STABILITY FROM A DISCIPLINED STRATEGY

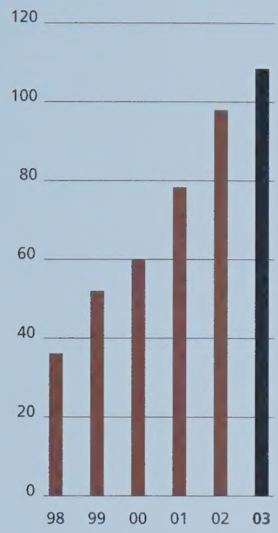
Since inception in 1996, we have been uncompromising in executing a proven business plan of investing in strategically located properties that are leased long term to highly creditworthy tenants, with matching long-term financing to stabilize our income. We adhere to this disciplined and successful approach, regardless of the type of asset we are acquiring.

In the process, we regularly add higher quality properties and prune non-strategic assets from the portfolio to strengthen earnings. By signing on rock-solid tenants such as Bell Canada, TransCanada Pipelines, Lowe's, Purolator, Finning International and TELUS, H&R ensures security of rental income. The REIT's long-term leases also have contractual rental uplifts that steadily augment cash flow throughout the inevitable economic and real estate cycles.

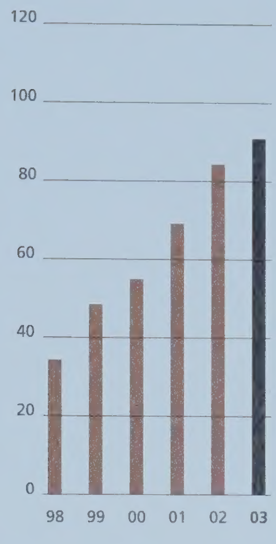
GROWTH FROM ACQUISITION AND DEVELOPMENT

With an unwavering pursuit of stability, security and profitable growth over the past seven years, we have steadily increased H&R's asset base to $2.7 billion, primarily through accretive acquisitions. In 2003, the REIT invested $670 million in 48 properties. We have penetrated many markets in the eastern half of the United States over the past two years, buying properties leased on a long-term basis to strong tenants, such as Lowe's, Georgia Pacific, Wal-Mart, Home Depot and Walgreens, and have become a respected buyer in a market where there is huge potential for further growth.

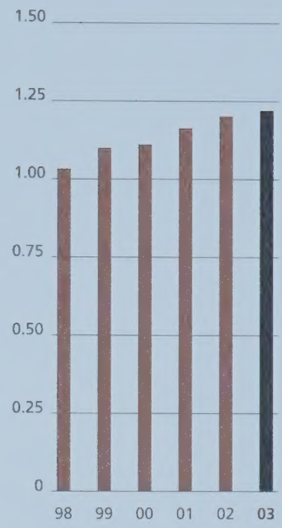
We are creating additional value by providing mezzanine financing for selected development projects, whereupon we typically exercise our option to acquire the property upon lease-up. An example of this successful program is the current construction of a $65 million, 243,000 square foot expansion at our Bell Canada complex in Mississauga, Ontario, scheduled to open in July 2004.



Distributable income
($ millions)



Net earnings
($ millions)



Cash distributions per unit
($)

ASTUTE FINANCIAL MANAGEMENT

Using a conservative approach to investment and asset management, we have successfully increased earnings and distributions to unitholders, and maintained a strong balance sheet, which has provided us with access to capital to finance our growth. The average payout to unitholders in 2003 was 85% of distributable income. As much as 97% of H&R's total debt is locked in at fixed interest rates, with maturities spread out an average 12 years, and 50% of our debt is non-recourse to the REIT. We raised $100 million from a private placement and completed a $127 million public offering – proceeds of which were used to fund H&R's acquisitions and mezzanine financing program and for debt reduction. As a result, the REIT's liquidity increased, resulting in a ratio of debt to gross book value of 61% at year end.

Sound financial management has been a key driver of dependable performance and rising unitholder value. H&R produced a total return on investment, including distributions and capital appreciation, of 29% in 2003, and a compound average of 17% annually since inception in 1996. It is no wonder that the REIT's market capitalization expanded by nearly 45% last year.

ENCOURAGING OUTLOOK

Broadly speaking, we view North American real estate markets as generally favourable for our business. Although the office leasing sector is soft, good economic growth and relatively low interest rates are conducive to the pursuit of additional acquisitions with attractive returns. Looking ahead, we see H&R continuing to attract investors seeking the appealing combination of security, stable distributions, tax deferrals and capital appreciation. We anticipate that our high-quality portfolio and disciplined strategy will continue to produce predictable cash distributions, despite inevitable cyclical market conditions.

The cornerstones of our success over the years – integrity, honesty, conservatism and dependability – keep us well grounded and guide our investment decisions and business practices. On behalf of our Board of Trustees, I extend sincere thanks to our investors, employees and business partners for their trust and support. We look forward to building additional value for these important stakeholders in 2004 and beyond.

Tom Hofstedter
March 31, 2004

UNITED PARCEL SERVICE DISTRIBUTION FACILITY

Location: Oakville, Ontario
Rentable area: 255,000 square feet, logistics warehouse
Highlights: H&R acquired this industrial facility for $17 million, and after putting long-term financing in place, the transaction generated a levered return in excess of 16%. The property is leased to UPS Logistics Group.

BORDERS DISTRIBUTION FACILITY

Location: Columbus, Ohio
Rentable area: 172,000 square feet, distribution warehouse
Highlights: H&R purchased this property for a price of $10.6 million and produced a return on equity of over 14%. The building is leased to Borders – a worldwide operator of 1,260 book stores with sales of over US $3 billion.

TRANSCANADA TOWER

Location: Downtown Calgary, Alberta
Rentable area: 936,000 square feet, Class A office tower
Highlights: H&R provided mezzanine financing for the original development of this 33-storey office building, acquired it in 2001 and generated a 17% levered return on equity.

PLACE BELL CANADA

Location: Downtown Ottawa, Ontario
Rentable area: 991,000 square feet, Class A office tower
Highlights: H&R acquired this 27-storey office building in 2002 for $224 million. The nation's capital has the highest office occupancy rate of all major metropolitan areas in Canada.

LOWE'S HOME IMPROVEMENT STORES

Acquired in 2003
Locations: Alabama, Mississippi, Pennsylvania, Indiana
Rentable area: 497,000 square feet in four retail stores
Highlights: H&R purchased these four stand-alone properties for a total price of $55 million. With long-term leases and financing in place, the acquisitions generated an average levered return on investment of over 14%. Lowe's is the world's second largest home improvement retailer – an A-rated company with 875 stores and US $26 billion in sales.

AMERICREDIT CALL CENTRE

Location: Peterborough, Ontario
Rentable area: 89,000 square feet, Class A office building
Highlights: H&R acquired this new, state-of-the-art call centre for $18 million, generating a levered return on investment of nearly 21%. The building is leased for 24 years to the City of Peterborough, which sublets to AmeriCredit Corp. – a continental consumer finance company with US $8 billion in assets.

OFFICE PROPERTIES *As at December 31, 2003*

Properties	Ownership Interest	Year Built/ Renovated	Net Rentable Area (Square Feet)	Occupancy	Major Tenants
160 Elgin St. Ottawa, ON	100%	1971	987,328	99%	Bell Canada, Public Works of Canada, Gowling, Strathy & Henderson, Accenture
450-1st St., S.W. Calgary, AB	100%	2001	936,000	100%	TransCanada PipeLines
411-1st St., S.E. Calgary, AB	50%	1981	705,120	99%	TELUS Communications, Public Works of Canada
310-320-330 Front St. W. Toronto, ON	70%	1989/1990	591,779	94%	Galileo Canada, National Bank, Royal Bank of Canada, Laurentian Financial Services
5099 Creekbank Rd. Mississauga, ON	100%	2002	525,921	100%	Bell Mobility
100 Wynford Dr. Toronto, ON	100%	1970/1997	459,171	100%	Bell Canada
200 Bouchard Boul. Dorval, QC	100%	1969/1997	451,899	100%	Bell Canada
401-405 The West Mall Etobicoke, ON	70%	1983/1985	421,157	80%	Livgroup Investments Inc., Parmalat, Diageo Canada Inc., Blockbuster Canada, Royal Bank of Canada
25 Sheppard Ave. W. North York, ON	70%	1994	360,381	99%	Nestlé Canada, Transcontinental Media Inc., Hewitt & Associates, Association of Professional Engineers of Ontario
160 McNabb St. Markham, ON	100%	1986	220,000	100%	AC Nielsen Company of Canada
26 Wellington St. E. Toronto, ON	70%	1981	172,569	98%	Map Info Canada, United Way, Sceptre Investments
55 Yonge St. Toronto, ON	70%	1956/1989	159,688	87%	CIBC, TransCanada PipeLines
145 Wellington St. W. Toronto, ON	70%	1987	154,479	99%	American International Group, Aon Consulting
110 Sheppard Ave. E. North York, ON	50%	1993	152,835	59%	Equifax Canada Inc., Eckler Partners
2810 Matheson Blvd. E. Mississauga, ON	35%	1990	140,171	100%	Credit Union Central of Ontario, Navigant International Canada
649 North Service Rd. Burlington, ON	100%	1991	123,000	100%	Wescam Inc.
2780-2800 Skymark Ave. Mississauga, ON	60%	1988/1990	107,484	82%	CIBC, Fritz Starber Inc., McDonald's, Firkin Pubs
6900 Maritz Dr. Mississauga, ON	100%	2001	104,689	100%	Maritz Canada Inc.
1235 Bay St. Toronto, ON	100%	1973/2000	96,957	92%	Dental Anesthesia Associates, Interac Business Centres, Markie Pharmacy
2611-3rd Ave. Calgary, AB	50%	1998	95,465	100%	Dominion Information Services Inc.
631 South Olive St.* Los Angeles, CA	100%	1986	90,112	96%	M.K. Diamonds, Toyo Pearls
291-295 The West Mall Etobicoke, ON	70%	1978	89,516	78%	Parmalat, Investors Group Financial Services
200 Jameson Dr. Peterborough, ON	100%	2001	89,405	100%	AmeriCredit
69 Yonge St. Toronto, ON	70%	1914/1988	86,737	90%	Livingston Group, Shoppers Drug Mart, Union Securities
1 Kenview Blvd. Brampton, ON	100%	1989	79,752	100%	Atlantis Aerospace Corp.
88 McNabb St. Markham, ON	70%	1987	74,260	0%	–
3625 Dufferin St. North York, ON	70%	1965/1985	71,275	100%	H&R Property Management Ltd., Qualified Financial Services
2767-2nd Ave. Calgary, AB	100%	1998	69,630	100%	DeVry Inc.
131 McNabb St. Markham, ON	100%	1989	54,100	100%	Drug Trading Company Ltd.
Total			7,670,880	96%	

** Held through a wholly owned US subsidiary.*

SINGLE-TENANT INDUSTRIAL PROPERTIES *As at December 31, 2003*

Properties	Ownership Interest	Year Built/ Renovated	Net Rentable Area (Square Feet)	Occupancy	Major Tenants
110 Circuit City Rd. * Marion, IL	100%	2000/2001	1,078,450	100%	Circuit City
170 Butts St. * South Hill, VA	100%	1998/2001	817,000	100%	Jones Apparel Group Inc.
2300 Rue Senkus LaSalle, QC	100%	1972	742,000	100%	Owens-Illinois Canada Corp.
220 Chemin du Tremblay Boucherville, QC	100%	1999	727,966	100%	Rona Inc.
12090 Sage Point Ct.* Reno, NV	100%	1997	690,000	100%	Sherwin Williams
55 West Dr. Brampton, ON	100%	1969/1981	505,565	100%	Winners Apparel Ltd.
1880 Matheson Blvd. E. Mississauga, ON	100%	2003	389,313	100%	Eagle Global Logistics (Canada), UPS SCS Inc.
930 Sherwin Pkwy. * Buford, GA	100%	2003	358,771	100%	Sherwin Williams
500 Palladium Dr. Kanata, ON	100%	2000/2001	329,612	100%	Breconridge Manufacturing Solutions Corporation
4441-76th St. Calgary, AB	100%	1980	323,796	100%	UPS Logistics Group Canada, Cascades Tissue Group Inc.
137 Horner Ave. Etobicoke, ON	100%	1962	320,000	100%	Livingston Investments Ltd.
2121 Cornwall Rd. Oakville, ON	100%	1997/1998	314,166	100%	UPS Logistics Group Canada
1600 Lionell Boulet Varennes, QC	100%	1971	311,103	100%	Asea Brown Boveri Inc.
7830 Tranmere Dr. Mississauga, ON	100%	1985/1987	265,469	100%	Paperboard Industries Corporation
1595 North Service Rd. Oakville, ON	100%	2002	254,891	100%	UPS SCS Inc.
1 Chandaria Pl. Kitchener, ON	100%	1967	254,719	100%	Truserv Canada Co-operators Inc.
6580 Millcreek Dr. Mississauga, ON	100%	1999	249,634	100%	UPS Logistics Canada Ltd.
75 Frontenac Dr. Markham, ON	100%	1986	243,614	100%	Hyundai Auto Canada
901 Guelph Line Burlington, ON	100%	1955	227,444	100%	International Truck and Engine Corporation
6590 Millcreek Dr. Mississauga, ON	100%	1999	225,694	100%	NFC Canada Ltd.
1616 Eiffel St. Boucherville, QC	100%	1989/2001	186,793	100%	Corporate Express Canada Inc.
30 Aero Dr. Calgary, AB	100%	2001	184,377	100%	Purolator Courier Limited
3655 Weston Rd. Downsview, ON	100%	1970	184,266	100%	Standard Metals
2390 Argentia Rd. Mississauga, ON	100%	1984	179,054	100%	CRL Company, Golder Associates
3900 Gantz Rd. * Grove City, OH	100%	1992	172,300	100%	Borders, Inc.
16900-107th Ave., N.W. Edmonton, AB	100%	1961/1988	172,070	100%	Finning International Inc.
6660 Financial Dr. Mississauga, ON	100%	1998/1999	164,236	100%	Servi-Logistix Inc.
7575 Brewster Ave. * Philadelphia, PA	100%	1981	164,150	100%	Georgia Pacific Corp.
6735-11th St., N.E. Calgary, AB	100%	1979	163,899	100%	Finning International Inc.
2928-16th St., N.E. Calgary, AB	100%	1981/1994	163,280	100%	Nova Chemicals Corporation
1330 Martin Grove Mississauga, ON	100%	1972/2000	162,775	100%	SMG Corp.
351 Passmore Ave. Scarborough, ON	100%	1986	161,137	100%	Samuel, Son & Company Limited
10910-170th St., N.W. Edmonton, AB	100%	1977/1999	154,721	100%	Finning International Inc.
20600 Clark-Graham Ave. Montreal, QC	100%	2003	140,000	100%	Warnaco of Canada
11 Kenview Blvd. Brampton, ON	100%	1989	139,548	100%	Para Paints Canada Inc.
1, 4 & 8 Prince Andrew Pl. Toronto, ON	100%	1966	139,520	100%	Symcor Inc.

SINGLE-TENANT INDUSTRIAL PROPERTIES (continued) *As at December 31, 2003*

Properties	Ownership Interest	Year Built/ Renovated	Net Rentable Area (Square Feet)	Occupancy	Major Tenants
5550 Skyline Way Calgary, AB	100%	1984	124,805	100%	Hunting Oilfield Services (Canada) Ltd.
2841 Langstaff Rd. Vaughan, ON	100%	1996	123,529	100%	All Metal Machine Specialties Limited, Planet Paper Box Inc.
510 East Courtland St. * Morton, IL	100%	2000	123,090	100%	Georgia Pacific Corp.
17718-114th Ave. Edmonton, AB	100%	2000	121,315	100%	Purolator Courier Limited
7000 Rue Armand Quebec City, QC	100%	2000	120,584	100%	Purolator Courier Limited
19100-94th Ave. Surrey, BC	100%	1998/2001	112,819	100%	Finning International Inc.
525 Boxwood Dr. Cambridge, ON	100%	2003	111,996	100%	United Auto Parts Inc.
1350-1380 Matheson Blvd. E. and 5391 Ambler Drive Mississauga, ON	100%	1987	110,059	100%	Minuk Construction and Engineering
9300 Airport Rd. Hamilton, ON	100%	2000	93,357	100%	Purolator Courier Limited
200 Chisholm Dr. Milton, ON	100%	1991	91,828	100%	Asea Brown Boveri Inc.
1550 Creditstone Rd. Vaughan, ON	100%	2000	88,584	100%	Purolator Courier Limited
2600 Meadowvale Rd. Mississauga, ON	100%	2000	84,486	100%	Purolator Courier Limited
10300 Henri Bourassa St. Laurent, QC	100%	1976/1989	81,500	100%	Asea Brown Boveri Inc.
2 East Beaver Creek Rd. Richmond Hill, ON	70%	1988	79,024	82%	Minacs Worldwide Inc., Acura Technology
10430-178th St., N.W. Edmonton, AB	100%	1979	70,676	100%	Finning International Inc.
940 Gateway Dr. Burlington, ON	100%	1982	70,218	100%	Cygnal Technologies
6315 Kenway Dr. Mississauga, ON	100%	1999	68,678	100%	Katoen Natie Canada Company
John G. Diefenbaker Airport Saskatoon, SK	100%	2001	66,355	100%	Purolator Courier Limited
1060 Tristar Dr. Mississauga, ON	100%	1984	65,284	100%	Annan & Bird Lithographers Ltd.
118 MacDonald Cres. Fort McMurray, AB	100%	1977	65,169	100%	Finning International Inc.
3620-32nd St., N.E. Calgary, AB	100%	1983/1998	65,120	100%	Nova Chemicals Corporation
1764 & 1776 Kelly Douglas Rd. Kamloops, BC	100%	1965/1989	64,271	100%	Finning International Inc.
9201 Rue de l'Innovation Anjou, QC	100%	2000	62,691	100%	Purolator Courier Limited
6520 Kestrel Rd. Mississauga, ON	100%	2000	62,217	100%	Purolator Courier Limited
2005 Boul. Dagenais Laval, QC	100%	2000	62,217	100%	Purolator Courier Limited
550 York Rd. Niagara-on-the-Lake, ON	100%	2000	62,185	100%	Purolator Courier Limited
3104-97th St. Edmonton, AB	100%	2000	62,169	100%	Purolator Courier Limited
880 Milner Ave. Scarborough, ON	70%	1990	60,028	100%	House of Electrical, Lombardi Direct Marketing
2860 Plymouth Dr. Oakville, ON	100%	1989	59,396	100%	Kraft Canada Inc.
1 Moyal Ct. Vaughan, ON	70%	1991	52,792	100%	Wajax Industries
5 Bodrington Ct. Markham, ON	70%	1994	50,000	100%	Belmont Press
Industrial Park W. Peace River, AB	100%	1970	44,668	100%	Finning International Inc.
5321-11th St. N.E. Calgary, AB	100%	1991	43,000	100%	Olympic Seismic Ltd.
360 Spinnaker Way Vaughan, ON	70%	1995	41,944	100%	The Packaging Group
2815 Matheson Blvd. E. Mississauga, ON	70%	1987	40,000	100%	ADT Security Services

SINGLE-TENANT INDUSTRIAL PROPERTIES (continued) *As at December 31, 2003*

Properties	Ownership Interest	Year Built/ Renovated	Net Rentable Area (Square Feet)	Occupancy	Major Tenants
380 Spinnaker Way Vaughan, ON	70%	1995	33,017	100%	Topax Export Packaging
4248-14th Ave. Markham, ON	70%	1994	32,708	100%	Linsey Foods Limited
749 Douglas Fir Rd. Sparwood, BC	100%	1978	31,784	100%	Finning International Inc.
300 Biscayne Cres. Brampton, ON	70%	1996	31,606	100%	Dicom Express Inc.
6740-67th Ave. Red Deer, AB	100%	1975	30,655	100%	Finning International Inc.
1604 & 1720 Willow St. Campbell River, BC	100%	1980	30,000	100%	Finning International Inc.
19498-92nd Ave. Surrey, BC	100%	1992	28,621	100%	Finning International Inc.
45 Bodrington Ct. Markham, ON	70%	1992	28,089	100%	Canada Bread Company Limited
450 Mackenzie Ave. & 265 Fifth Ave. S. Williams Lake, BC	100%	1959/1978	27,321	100%	Finning International Inc.
2400 Matheson Blvd. E. Mississauga, ON	70%	1993	25,273	100%	Givaudan Roure
5230 Orbitor Dr. Mississauga, ON	70%	1994	22,000	100%	W.K. Buckley Limited
Mile 49.5 Alaska Hwy. Fort St. John, BC	100%	1979	21,259	100%	Finning International Inc.
4750-101 St. N.W. Edmonton, AB	100%	1978	20,457	100%	Finning International Inc.
700 Vanalman Ave. Victoria, BC	100%	1990	14,411	100%	Finning International Inc.
R.R. #1, Mile 295, 2600 Alaska Hwy. Fort Nelson, BC	100%	1980	12,399	100%	Finning International Inc.
Total			14,356,987	99%	

* *Held through a wholly owned US subsidiary.*

RETAIL PROPERTIES *As at December 31, 2003*

Properties	Ownership Interest	Year Built/ Renovated	Net Rentable Area (Square Feet)	Occupancy	Major Tenants
720 Maloney Blvd. W. Gatineau, QC	100%	1995/1998	283,970	100%	Wal-Mart, Canadian Tire, Metro Richlieu
NorthPointe Towne Centre Calgary, AB	100%	2000	199,502	100%	Famous Players, Canadian Tire
7500 Lundy's Lane Niagara Falls, ON	100%	1999/2001	172,800	100%	Tommy Hilfiger, Levi's, Roots Canada, Nike, Danier Leather
10450-42nd Ave. Edmonton, AB	100%	1993	150,457	100%	Rona Revy Inc.
220 Chain Lake Dr. Halifax, NS	100%	1996/1998	138,027	100%	Wal-Mart
1701 Frederick Rd. * Opelika, AL	100%	1999	135,197	100%	Lowe's Companies, Inc.
2301 Woodmont St. * Columbus, MS	100%	2001	135,197	100%	Lowe's Companies, Inc.
3505 North Memorial Pkwy. * Huntsville, AL	100%	2002	135,039	100%	Lowe's Companies, Inc.
575 Molly Lane * Woodstock, GA	100%	1997	132,847	100%	Lowe's Companies, Inc.
733 Pleasant Hill Rd. * Lilburn, GA	100%	1997	132,847	100%	Lowe's Companies, Inc.
2650 Dallas Hwy. * Marietta, GA	100%	1997	132,847	100%	Lowe's Companies, Inc.
8199 Pearl Rd. * Strongsville, OH	100%	1997	132,448	100%	Home Depot
2495 Gulf To Bay Blvd. * Clearwater, FL	100%	1997	131,946	100%	Home Depot
200 Weis Lane (off Susquehanna Blvd.) * West Hazelton, PA	100%	1997	131,575	100%	Lowe's Companies, Inc.
10580 Duke Dr. * Alpharetta, GA	100%	1998	129,044	100%	Lowe's Companies, Inc.
4855 Stone Mountain Hwy. * Lilburn, GA	100%	1999	128,997	100%	Lowe's Companies, Inc.
2435 East-West Connecter * Austell, GA	100%	2003	115,396	100%	BJ's Wholesale Club

RETAIL PROPERTIES (continued) *As at December 31, 2003*

Properties	Ownership Interest	Year Built/ Renovated	Net Rentable Area (Square Feet)	Occupancy	Major Tenants
1701-1711 Merivale Rd. Ottawa, ON	100%	2002	114,753	100%	Loeb's, Best Buy, Linens 'N Things
1711 Springfield Rd. Kelowna, BC	100%	1995	110,178	100%	Rona Revy Inc.
5555 S. Buckner Blvd. * Dallas, TX	100%	1991/1997	107,927	100%	Sam's Club
275 Rideau Blvd. Rouyn-Noranda, QC	20%	1996/1998	104,222	100%	Wal-Mart
711 Creek View Dr. * Columbus, IN	100%	1994	95,120	100%	Lowe's Companies, Inc.
2665-32nd St., N.E. Calgary, AB	100%	1998	89,438	100%	Rona Revy Inc.
Interstate 640 at Washington Pike * Knoxville, TN	100%	1997	86,584	100%	Kohl's
110 Bloor St. W. Toronto, ON	100%	1997/1998	86,164	100%	Indigo Books, Nike, Escada
1058-1100 10th St. Hanover, ON	100%	2001	78,114	100%	Wal-Mart
124 & 128 Boston Post Rd. * Waterford, CT	100%	1996/2002	65,506	100%	Shaw's
8150 Rockville Rd. * Indianapolis, IN	100%	1995	61,614	100%	Kroger
9950 Berberich Dr. * Florence, KY	100%	1997	60,835	100%	Winn Dixie Stores Inc.
4478 Market St. * Marianna, FL	100%	1997	58,100	100%	Winn Dixie Stores Inc.
4211-137 Ave & 4204-137 Ave. Edmonton, AB	100%	1996/1998	55,963	100%	Cineplex Odeon Corporation
5428 Dogwood Dr. * Milton, FL	100%	1984/1996	43,750	100%	Winn Dixie Stores Inc.
61st Ave. & Barlow Tr. S.E. Calgary, AB	100%	1998/1999	40,480	100%	Business Depot
Sunridge Plaza Calgary, AB	100%	2000	35,332	100%	Mark's Work Warehouse, CIBC
1157 Azalea Ave. * Richmond, VA	100%	1997	13,905	100%	Walgreens Company
1225 East Ridge Rd. * Griffith, IN	100%	1997	13,905	100%	Walgreens Company
1459 Tiger Park Lane * Gulf Breeze, FL	100%	2002	13,840	100%	Walgreens Company
7112 Hwy. 98 * Panama City, FL	100%	1997	11,200	100%	Eckerd Corporation
1347 West 15th St.* Panama City, FL	100%	1997	11,200	100%	Eckerd Corporation
6217 Silver Star Rd. * Orlando, FL	100%	1997	11,200	100%	Eckerd Corporation
302 N. Tyndall Pkwy. * Callaway, FL	100%	1997	11,200	100%	Eckerd Corporation
2701 Dick Pond * Surfside Beach, SC	100%	1997	10,908	100%	Eckerd Corporation
800 North Glynn St. * Fayetteville, GA	100%	2000	10,908	100%	Eckerd Corporation
Total			3,920,482	100%	

* *Held through a wholly owned US subsidiary.*

MEZZANINE FINANCING FOR DEVELOPMENT *As at December 31, 2003*

Properties	Property Type	Ownership Option	Expected Completion	Net Rentable Area (Square Feet)	Occupancy	Major Tenants
Eglinton Ave. E. & Dixie Rd. Mississauga, ON	Office	100%	July 2004	243,000	100%	Bell Mobility
Derry Rd. & Hwy. 10 Mississauga, ON	Office	100%	N/A	N/A	N/A	N/A
101 Edgeley Blvd. Vaughan, ON	Retail	50%	N/A	N/A	100% (Wal-Mart only)	Wal-Mart
Front St. W. & John St. Toronto, ON	Office	100%	N/A	N/A	N/A	N/A
Total				N/A		

For the year ended December 31, 2003

OVERVIEW

H&R Real Estate Investment Trust (the "REIT") is an unincorporated closed-end trust created by a Declaration of Trust and governed by the laws of the Province of Ontario.

The REIT commenced operations on December 23, 1996 with the initial acquisition of a 70% undivided interest in a portfolio of 27 properties, principally located in the Greater Toronto Area. As at December 31, 2003, the REIT owned and operated a portfolio of 158 properties (29 office, 86 single-tenant industrial and 43 retail), comprising an aggregate leasable area of 24.5 million square feet (as calculated at the REIT's level of ownership), and had invested $91.7 million as mezzanine financing for four development projects.

The REIT's portfolio falls into the following geographic regions: 26 industrial properties, four office properties and seven retail properties are located in Western Canada; one industrial property, one retail property and two office properties are located in Eastern Ontario; seven industrial properties, one office property and two retail properties are located in Central Ontario; nine industrial properties, one office property and three retail properties are located in Eastern Canada (including Quebec); seven industrial properties, one office property and 29 retail properties are located in the United States; and the balance of the properties (57) and the four development projects are located in the Greater Toronto Area.

The REIT has two primary objectives:

- to provide unitholders with stable and growing cash distributions, generated by revenue it derives from investments in income-producing real estate properties; and
- to maximize unit value through ongoing active management of the REIT's assets, through acquisitions of additional properties and the provision of mezzanine financing for selected development projects.

NET EARNINGS AND FINANCIAL POSITION

The financial information as at December 31, 2003 and the results of operations for the year then ended are presented in accordance with Canadian generally accepted accounting principles. The following discussion should be read in conjunction with the consolidated financial statements of the REIT and the notes thereto for the years ended December 31, 2003 and 2002.

RESULTS OF OPERATIONS

Net earnings for the year ended December 31, 2003 of $90.6 million, or $1.21 per unit, increased by 7.8% on a dollar basis and 0.8% on a per unit basis over the $84.0 million, or $1.20 per unit, for the year ended December 31, 2002. Depreciation of $19.6 million (2002 – $15.4 million) and amortization of $4.2 million (2002 – $4.1 million) are included in the determination of net income. The REIT does not consider depreciation expense when calculating distributions paid to unitholders.

QUARTERLY INFORMATION

Three-month Periods Ended

(Unaudited) *(in thousands of dollars, except per unit amounts)*	**Dec. 31, 2003**	**Sept. 30, 2003**	**June 30, 2003**	**March 31, 2003**	Dec. 31, 2002	Sept. 30, 2002	June 30, 2002	March 31, 2002
Rentals from income properties	**$ 86,147**	**$ 81,792**	**$ 78,483**	**$ 75,222**	$ 76,990	$ 73,953	$ 73,178	$ 64,390
Mortgage interest and other income	**2,356**	**2,967**	**1,711**	**5,195**	1,011	1,243	1,757	3,978
Earnings from operations	**24,737**	**23,915**	**21,975**	**24,769**	21,302	21,917	22,160	23,015
Earnings from operations per unit (basic)	**0.31**	**0.32**	**0.30**	**0.35**	0.30	0.31	0.32	0.33
Net earnings	**23,378**	**22,740**	**20,816**	**23,619**	20,289	20,821	21,051	21,861
Net earnings per unit								
(basic)	**0.29**	**0.30**	**0.29**	**0.33**	0.29	0.29	0.30	0.31
(diluted)	**0.29**	**0.30**	**0.28**	**0.33**	0.28	0.29	0.30	0.31

RENTALS FROM INCOME PROPERTIES

Rental income from income properties increased 11.5% from $288.5 million to $321.6 million in 2003. The increase is primarily a result of the REIT's ongoing strategy of adding to its properties either through acquisitions or its mezzanine financing program.

A total of 48 properties were added and three properties were sold during the year, representing a net increase in the book value of income properties (after depreciation) of $588.6 million.

Property operating costs, and mortgage and other interest have also increased from $109.4 million and $79.3 million to $113.6 million and $101.1 million respectively in 2003. These increases reflect the increase in activity resulting from the additional properties added to the REIT's portfolio. See "Changes in Financial Position – Income Properties" below.

The overall occupancy rate in the REIT's portfolio as at December 31, 2003 remains at 99%, unchanged from December 31, 2002. The exposure to lease rollovers as a result of lease expiries over the next five years (as a percentage of the REIT-owned portion of the properties) is as follows:

2004	2.0%
2005	1.5%
2006	1.7%
2007	2.6%
2008	5.6%
	13.4%

Due to the quality of its portfolio, H&R occupancy rates were higher at year end than the Canadian national averages as compiled by Royal LePage Commercial Inc. and Colliers International.

December 31, 2003	Office	Industrial	Retail
Canadian average	**88.4%**	**95.5%**	**94.6%**
H&R portfolio average	**96.0%**	**99.0%**	**100.0%**

MORTGAGE INTEREST AND OTHER INCOME

The REIT earned $12.2 million in mortgage interest and other income in 2003 compared to $8.0 million in 2002, an increase of 53.1%. Included in this amount are gains on sale of income properties (see "Sale of Income Properties" below) of $4.4 million (2002 – $1.4 million). The balance of this type of income (when excluding gains on sale) has therefore increased by 19.4% or $1.3 million from $6.6 million for the year ended December 31, 2002 to $7.9 million for the 2003 fiscal year.

This overall increase primarily reflects the increase in the average mortgage receivable asset balance between December 31, 2002 and 2003 (see "Changes in Financial Position – Mortgages Receivable" below). Should fewer development opportunities arise in the future, this trend could then reverse itself. The weighted average interest earned on these investments in 2003 was approximately 9.9% (2002 – 8.8%), which increase was also a contributing factor in the increase of this year's interest income over the 2002 year.

SALE OF INCOME PROPERTIES

The REIT's philosophy is to dispose of assets that no longer fit its investment strategy and then re-deploy the proceeds in more attractive investment opportunities.

During the first quarter of 2003, the REIT disposed of one non-core 148,000 square foot office property, generating a gain of $3.7 million. In the third quarter, the REIT disposed of two retail assets, yielding a $0.7 million gain. The total net gain on sales for 2003 amounted to $4.4 million. During 2002, the REIT disposed of two properties and certain excess land for a gain of $1.4 million.

TRUST EXPENSES

Trust expenses increased slightly from $4.4 million in 2002 to $4.8 million in 2003, a 10.8% increase, which reflects the increase in size and activity of the REIT. These expenses amount to 1.5% of rentals from income properties, similar to the previous year's 1.5%, a percentage that is amongst the lowest in the Canadian real estate industry.

DISTRIBUTION TO UNITHOLDERS

The REIT is currently required to distribute not less than 80% of its normalized distributable income to unitholders on a monthly basis in accordance with its Declaration of Trust. Readers are cautioned that distributable income and normalized distributable income are non-GAAP measures and should not be construed as an alternative to net earnings determined in accordance with GAAP as an indicator of the REIT's performance. The REIT's method of calculating distributable income may differ from other issuers' methods, and accordingly, distributable income may not be comparable to measures used by other issuers.

Depreciation, accrued rent and other non-cash items (including gains on sale) are added to, or deducted from, net earnings to determine the amount of income available for distribution. Accrued rent represents the adjustment made to normalize rents for certain tenants whose rental rate increases substantially over the term of their respective leases. This adjustment is required by Canadian generally accepted accounting principles and represents a non-cash item to be deducted in determining distributable income.

Distributable income increased to $108.6 million or $1.45 per unit for the year ended December 31, 2003 from $97.8 million or $1.39 per unit for the same period in fiscal 2002.

The primary reason for this increase is the higher capital gains realized in 2003 of $4.4 million compared to $1.4 million in 2002 (see "Sale of Income Properties" above). The balance of the increase is attributable to the ongoing acquisition of properties throughout 2003 plus rental escalations in existing leases, and to the higher rate of interest earned on mortgage receivables (see "Mortgage Interest and Other Income" above). However, this increase has been offset by the general softening in the multi-tenant office market in the GTA, which has given rise to lower rents on renewal and new leasing, as well as slightly higher vacancies in the office portfolio.

Since December 31, 2002 office occupancy has decreased by approximately 1%. This can be attributed primarily to three different leases in our suburban GTA office portfolio for which the timing of re-leasing is unknown at this point, offset by one additional lease in the Place Bell Canada office tower in Ottawa, totalling a net 65,000 square foot reduction. At an average gross rental of $32 per square foot, the negative impact on distributable income for the year has been approximately $1.9 million or $0.03 per unit.

Adjusting for these capital gains previously mentioned will result in normalized distributable income of $104.2 million or $1.40 per unit for the year ended December 31, 2003 as compared to $96.4 million or $1.37 per unit for the same period in 2002. The actual percentage increase for normalized distributable income per unit for the year ended December 31, 2003 is approximately 2% over the equivalent 2002 period.

Total distributions for the year ended December 31, 2003 amounted to $92.5 million or 85.2% of distributable income, compared to $84.3 million or 86.2% of distributable income for the 2002 year. This percentage is virtually unchanged, as the higher payout per unit in 2003 for the full year at 10.2 cents per unit per month is offset in percentage terms by the larger capital gains realized in 2003 included in distributable income as previously described.

The percentage of distributions to normalized distributable income described previously is 88.8% for the year ended December 31, 2003 (2002 – 87.4%). The percentage increased slightly due to the dilutive effect of the equity raise in December 2003 (see "Unitholders' Equity" below), which impacted distributable income by over half a cent per unit in the fourth quarter of 2003.

The tax deferred portion of the distributions declined slightly from 53% in 2002 to 52% in 2003. The deferral will vary in any given year due to factors such as the size and timing of unit offerings and the acquisition of properties and provision of mezzanine financing for development projects.

CALCULATION OF DISTRIBUTABLE INCOME

(In thousands of dollars)	**December 31, 2003**	December 31, 2002
Net earnings	**$ 90,553**	$ 84,022
Add (deduct): Depreciation	**19,585**	15,395
Accrued rent	**(1,585)**	(1,585)
Distributable income	**$ 108,553**	$ 97,832

CHANGES IN FINANCIAL POSITION

ASSETS

Income Properties

The REIT acquired an interest in 48 properties and disposed of three properties during the year. The acquisitions continued the REIT's investment strategy of acquiring quality assets occupied by long-term creditworthy tenants. Funds for these acquisitions were obtained primarily by issuing new trust units (see "Unitholders' Equity" below), by utilizing our short-term acquisition line and by securing long-term fixed rate borrowing.

During the first quarter ended March 31, 2003, the REIT acquired five properties and disposed of one property.

In January 2003, a non-core multi-tenant office building located in Toronto, Ontario, totalling 148,000 square feet was sold for gross proceeds of $22.5 million, realizing a gain of $3.7 million.

In February 2003, the REIT acquired a new 255,000 square foot logistics warehouse in Oakville, Ontario, for approximately $17.4 million. The property is leased to UPS Logistics Group.

During March 2003, three free-standing retail home improvement stores leased to Lowe's Companies Inc. were purchased for approximately $60.6 million. The stores, comprising a total of 395,000 square feet, are all located in the Atlanta, Georgia, area. An additional 11,000 square foot retail store leased to Eckerd Corporation in the same region was purchased for $4.6 million.

During the second quarter, the REIT acquired 25 properties, mainly in the United States.

In April 2003, three single-tenant industrial properties totalling 460,000 square feet, leased to Borders Inc. and Georgia Pacific Corporation on long-term leases, were purchased for approximately $28.0 million.

During May 2003, the REIT purchased 21 retail properties and one industrial property.

A portfolio of 17 retail properties leased to investment grade tenants with approximately 15 years remaining on their leases was purchased from New York Life. These single-tenant free-standing retail stores comprising 834,000 square feet were purchased for $112.3 million. An additional two retail stores totalling 147,000 square feet located in Georgia and Florida were purchased for $25.2 million.

Finally, in Canada, three properties were acquired. A 150,000 square foot Rona Inc. retail store located in Edmonton was purchased for $14.6 million. A 122,000 square foot power centre in Ottawa, tenanted by Best Buy, Linens 'N Things and Loebs, was purchased for $22.7 million and, lastly, a 112,000 square foot industrial distribution centre leased long term to UAP Inc. in Cambridge, Ontario, was purchased for $6.7 million.

During the third quarter, the REIT acquired four properties, all in the United States, and sold two non-core retail properties.

In July 2003, the REIT disposed of a 41,000 square foot retail property in the United States, for $4.3 million, which finalized the New York Life deal. In August 2003, the REIT disposed of a non-core, 121,000 square foot property located in Calgary, Alberta, for gross proceeds of $16.7 million. The net gain realized on these two transactions was $0.7 million.

Finally, in September 2003, the REIT purchased four free-standing retail properties in the United States, leased on a long-term basis to national investment grade tenants.

Two Home Depot stores, totalling 264,000 square feet and having lease terms remaining for 19 years, were purchased for $41.2 million. Two Lowe's Home Improvement stores, totalling 271,000 square feet with leases remaining for 18 years, were purchased for $35.5 million.

During the fourth quarter, the REIT acquired 14 properties in both Canada and the United States.

In October 2003, the REIT purchased three properties in Canada and one in the United States.

In Ontario, the REIT acquired for $18.6 million an 89,000 square foot office building in Peterborough, leased for a remaining 24 years to the City. As part of the mezzanine financing program, the REIT exercised its right to purchase a 255,000 square foot industrial property in Kitchener at a total price of $7.3 million, also leased on a long-term basis. In Toronto, the REIT added to its portfolio a $10.2 million, 140,000 square foot industrial complex leased to Symcor Inc. for 15 years for use as a data centre.

In South Hill, Virginia, the REIT purchased for $40.4 million an 817,000 square foot distribution centre leased for 20 years to the Jones Apparel Group.

During November 2003, the REIT completed three additional transactions. Firstly, the REIT purchased for $17.3 million a new 115,000 square foot retail property situated outside Atlanta, Georgia, leased for 20 years. Secondly, for a combined $17.2 million, the REIT purchased a new 140,000 square foot industrial distribution facility in Montreal and a 78,000 square foot retail store in Hanover, Ontario, which retail store is leased to Wal-Mart on a long-term basis.

Finally, during December 2003, the REIT acquired an interest in five properties in Canada and two in the United States. Three of the properties are located in Ontario. The REIT paid approximately $32.0 million for a new 389,000 square foot logistics facility located in Mississauga, leased to Eagle Global Logistics and UPS SCS, Inc. The REIT also acquired a 220,000 square foot suburban office building in Markham for approximately $28.0 million. This property is leased to AC Nielsen on a long-term basis. The final Ontario acquisition was the $8.9 million purchase of a 227,000 square foot industrial building in Burlington, leased long-term to Navistar International Corporation.

The other two acquisitions in Canada were both in Calgary, Alberta. Firstly, the REIT purchased a 50% interest in the 28-storey, 705,000 square foot TELUS Tower located in Calgary's downtown financial core. The project is essentially fully leased, of which 93% is leased to TELUS Corporation for another 13 years, subject to certain limited rights of early termination. The second acquisition was a 125,000 square foot industrial facility, leased for 15 years at an $8.0 million cost.

In the United States the REIT purchased two new industrial properties for approximately $52.0 million, one being 690,000 square feet in Nevada and the second being 360,000 square feet in Atlanta, Georgia. Both are leased for 15 years to Sherwin Williams Company, an investment grade rated corporation.

Consequently, as a result of these transactions, income properties increased by 30.6% to $2.511 billion at December 31, 2003 from $1.922 billion at December 31, 2002. The dollar figures shown above for US acquisitions are based on the currency exchange rates at the time of such acquisitions and not at year end.

Mortgages Receivable

The REIT provides mezzanine financing for development projects that are consistent with the REIT's objectives and philosophy. These projects are secured through mortgage financing provided by the REIT, which receives an option to acquire an equity interest in the project. Construction financing is only provided after 70% of the project has been pre-leased. Participation in development projects enables the REIT to acquire high quality, new properties at higher yields than would otherwise be available.

At both December 31, 2003 and 2002, there were four projects for which the REIT had provided mezzanine development financing. In addition, at December 31, 2003, there was one mortgage receivable on a property sold in August 2003 amounting to $3.1 million.

Mortgages receivable increased 52.7% from $60.1 million at December 31, 2002 to $91.7 million at December 31, 2003. This increase is primarily due to an additional $29.9 million advanced on Phase II of the Bell Canada Complex in Mississauga, Ontario. The project is almost complete and the REIT expects to exercise its purchase option in July 2004.

Deferred Expenses

Deferred expenses increased slightly by $0.8 million from $28.9 million at December 31, 2002 to $29.7 million at December 31, 2003, an increase of 3.0%. This increase reflects the normal increase in activity resulting from properties added to the portfolio, offset by the ongoing amortization of this asset.

Other Assets

Accounts receivable were not significantly different between December 31, 2002 and December 31, 2003. The decrease of $1.4 million is a minor fluctuation arising during the normal course of business.

Certain leases call for rental payments that increase significantly over their term. Accrued rent receivable records the rental revenue from these leases on a straight line basis, resulting in accruals for rent that are not billable or due until future years.

Accrued rent for 2003 represents the adjustment for $1.6 million of rent from the Nestlé lease at the property located at 25 Sheppard Avenue West, Toronto. This accrual has increased accrued rent receivable by $1.6 million between December 31, 2002 and December 31, 2003 (2002 – $1.6 million) and this asset will continue increasing until 2004 when the balance will begin decreasing until it reaches zero at the lease's maturity in 2019. The annual adjustment for this item affecting the income statement will be removed from the calculation of distributable income each year as it does not represent a cash item.

Prepaid expenses and sundry assets increased from $11.5 million at December 31, 2002 to $11.8 million at December 31, 2003, an increase of 2.5%. This increase reflects a minor fluctuation arising during the normal course of business.

Cash and cash equivalents increased by $9.3 million from $10.2 million at December 31, 2002 to $19.5 million at December 31, 2003. Of the balance of $19.5 million, $2.6 million related to funds being held in escrow until the expiry of certain non-recourse public mortgage bonds and other non-recourse US mortgages. The other $16.9 million represents the balance of funds from the recent equity raise (see "Unitholders' Equity – Liquidity and Capital Resources" below) which has not yet been deployed in the acquisition of new assets.

LIABILITIES

The REIT's Declaration of Trust limits the indebtedness of the REIT to a maximum of 65% of the gross book value of the REIT. At December 31, 2003 the REIT's indebtedness was 60.9% compared to 59.3% at December 31, 2002. This increase is due to the increase in mortgages payable and bank indebtedness as outlined below.

Mortgages Payable

Mortgages payable increased by 30.3% from the December 2002 year-end figure of $1.239 billion to $1.615 billion at December 31, 2003. This $376.0 million net increase is a result of 27 separate transactions. Details of the more significant transactions are outlined as follows (the dollar figures shown below for US transactions are based on the currency exchange rates at the time of such transactions and not at year end):

Firstly, mortgages totalling $65.5 million maturing from 2017 to 2020 were assumed on the closing of the four Lowe's stores purchased in Georgia.

Secondly, mortgages of $78.9 million were secured on the closing of the New York Life portfolio maturing in 15 years.

Thirdly, a 10 year $16.5 million mortgage was obtained on a retail project in Ottawa.

Fourthly, in the fourth quarter, a $28.5 million 20 year mortgage was assumed on the closing of the Jones Apparel Distribution Centre, a $47.0 million mortgage was assumed on the purchase of a 50% interest in the TELUS Tower and two 15 year mortgages totalling $45.5 million were assumed on the closing of the Sherwin Williams industrial acquisitions.

Finally, two mortgages totalling $31.3 million were secured against the Home Depot facilities while two 18 year mortgages for $25.8 million were placed on the two additional Lowe's facilities purchased in September 2003.

These mortgages described above total $339.0 million, representing a significant portion of the $376.0 million net increase in mortgages payable. The balance of the increase relates to an additional 12 mortgages being secured during the year.

The mortgages payable balance was however reduced by $11.1 million with the sale of the office property at 250 University Avenue, Toronto, when the mortgage was assumed by the purchaser, as well as by the regular monthly self-amortizing principal payments made in the normal course of business operations.

The mortgages bear interest at the weighted average rate of 7.0% (2002 – 7.4%) and mature between 2004 and 2026. To reduce risk, management has attempted to closely match the weighted average term to maturity of the mortgages of

11.9 years to the remaining average lease term of 12.7 years. Going forward, management anticipates the REIT will be able to renew its debt as it matures. Future principal payments as a percentage of mortgages payable are as follows:

2004	4.5%
2005	4.2%
2006	4.5%
2007	5.5%
2008	7.8%
Thereafter	73.5%

Bank Indebtedness

Liabilities at December 31, 2003 included bank indebtedness of $56.3 million compared to $1.3 million at December 31, 2002, an increase of $55.0 million. The Canadian dollar portion of the debt bears interest at rates approximating the prime rate of a Canadian chartered bank, while the US portion of the debt (Canadian equivalent of $55.9 million at December 31, 2003 compared to $0.17 million at December 31, 2002) bears interest at LIBOR rates. The balance of cash on hand from the December equity issue of approximately $16.9 million was not used to pay down the US debt as the rate obtained at year end by investing these funds was greater than the interest paid on the US debt at the time. This situation is regularly monitored to ensure the most appropriate use is being made of excess cash on hand.

The bank indebtedness is secured by fixed charges over certain income properties and is due on demand. These funds were primarily used to provide the equity required for the asset purchases previously described and to provide additional mezzanine financing for development projects.

Accounts Payable

Accounts payable decreased by $0.4 million from $42.7 million at December 31, 2002 to $42.3 million at December 31, 2003. The decrease reflects regular fluctuations occurring in the normal course of business operations.

UNITHOLDERS' EQUITY

During April 2003, the REIT entered into an agreement to sell, on a private placement basis, $100 million of units to accounts managed by a single Canadian institutional money manager, with proceeds to be received in four equal tranches. The first three tranches of $25 million of trust units each were issued on April 30, 2003, July 31, 2003 and October 31, 2003, with the final tranche issued on January 15, 2004.

During November 2003, the Trust entered into an agreement with a syndicate of underwriters to issue and sell 7,100,000 trust units, with an option for up to an additional 1,065,000 trust units, at $15.50 per trust unit. The gross proceeds from this transaction of $127 million were received on December 9, 2003.

Unitholders' equity increased by $212.1 million between December 31, 2002 and December 31, 2003 primarily as a result of the proceeds from the REIT's distribution reinvestment program, the exercise of options by officers and trustees of the REIT during the period as well as by $202 million of trust units issued as described above.

CUMULATIVE FOREIGN EXCHANGE ADJUSTMENTS

As a result of the strengthening of the Canadian dollar against the US dollar during the year ended December 31, 2003, an unrealized loss of $11.4 million was recorded on the financial statements at December 31, 2003, as compared to a gain of $0.2 million at December 31, 2002. This amount reflects the net adjustment to the equity invested in US properties, with the REIT's debt being held in US dollars currently acting as a natural hedge against its total investment in US dollars. This amount fluctuates continuously depending on the US exchange rate but does not concern management at this point in time as all the US assets are long term in nature and no short-term realization of this loss is anticipated.

In addition, as part of the REIT's strategy of providing stable distributable income to its unitholders, the REIT has implemented a hedging strategy on its US income to minimize exposure to currency fluctuations.

LIQUIDITY AND CAPITAL RESOURCES

Funds from operations during the year ended December 31, 2003 amounted to $109.2 million, an increase from $101.6 million in the same period of 2002. This cash provided from operating activities, together with proceeds from issue of units, conventional mortgage financing and short-term bank financing (including a $140 million operating/acquisition facility with a Canadian chartered bank), has been used mainly to fund net property acquisitions of $387.4 million and distributions to unitholders of $92.5 million for the year ended December 31, 2003.

Management expects to be able to meet all of the REIT's ongoing obligations and to finance future growth through the issue of new equity as well as by using conventional real estate debt, short-term financing from the bank and through a related party, and the REIT's stable cash flow. In addition, the final $25 million tranche of new equity from the $100 million private placement was received on January 15, 2004 as described previously (see "Unitholders' Equity").

Proposed legislative changes in Ontario should clarify that unitholders in publicly traded trusts will not be liable for activities of the Trust. These changes would foster investor protection and confidence and represent an important step toward inclusion of REITs in the S&P/TSX Composite Index, which, in turn, would broaden the investor base to institutions such as pension funds and, as such, provide a future source of additional liquidity.

ACCOUNTING CHANGES

Firstly, the Canadian Institute of Chartered Accountants (CICA) has provided guidance for accounting for operating leases acquired in connection with the acquisition of real estate properties. This guidance requires that an enterprise acquiring real estate should allocate a portion of the purchase price to in-place operating leases, based on their fair value at the time of acquisition. A portion of the purchase price should also be allocated to customer relationships with existing tenants, which represents the probability that existing tenants will renew their leases. This standard is effective for acquisitions initiated on or after September 12, 2003 by the REIT.

Secondly, the CICA has issued a new standard explaining more clearly what constitutes Canadian generally accepted accounting principles (GAAP). The REIT is currently assessing and determining the impact on its current accounting policies. Two areas identified by the REIT are depreciation of income properties and revenue recognition from tenants. The new standard disallows the use of the sinking fund method of depreciation, which is currently used by the REIT. The new standard also requires revenue from all tenants to be recognized on a straight line basis. The REIT currently only records income from leases on a straight line basis when rent escalations are more than inflationary increases. This new standard is effective January 1, 2004 for the REIT and is to be applied prospectively.

Finally, the CICA has revised amounts for stock-based compensation and other stock-based payments, to require all transactions whereby goods and services are received in exchange for stock-based compensation and other stock-based payments to be recognized in the financial statements at fair value. This change effectively requires the REIT to expense the cost of stock options to employees for periods commencing January 1, 2004.

SUBSEQUENT EVENTS

On January 15, 2004, the fourth $25 million tranche of 1,849,605 trust units was issued pursuant to the terms of the private placement agreement (see "Unitholders' Equity" above).

The REIT acquired one industrial property in Canada and one retail property in the United States, totalling 230,000 square feet, at a cost of approximately $19.9 million.

RISKS AND UNCERTAINTIES

The REIT is exposed to interest rate risk on its borrowings. It minimizes this risk by restricting total debt to 65% of aggregate assets and by obtaining long-term fixed-rate debt to replace short-term floating-rate borrowings. In addition, the weighted average term to maturity of long-term debt is closely matched to the remaining average lease terms.

The REIT is exposed to credit risk as an owner of real estate in that tenants may become unable to pay the contracted rents. Management mitigates this risk by carrying out appropriate credit checks and related due diligence on the significant tenants. Management has diversified the REIT's holdings so that it owns several categories of properties (office, industrial and retail) and acquires properties throughout Canada and the United States. In addition, management ensures that no tenant or related group of tenants, other than investment grade tenants, accounts for a significant portion of the cash flow. The only tenants which account for more than 5% of the rentals from income properties of the REIT are TransCanada PipeLines, Bell Canada and Bell Mobility, but each individually represents less than 15% of the rentals from income properties of the REIT and currently is at least A rated by a recognized rating agency.

The REIT is also exposed to credit risk as a lender on the security of real estate in the event that a borrower is unable to make the contracted payments. Such risk is mitigated through credit checks and related due diligence of the borrowers and through careful evaluation of the worth of the underlying assets.

The REIT is exposed to foreign exchange fluctuations as a result of ownership of assets in the United States. In order to mitigate the risk of significant fluctuations, a hedging program has been implemented to protect income earned in US dollars.

The REIT has been structured to ensure that mandated investment guidelines and operating criteria are strictly adhered to. These policies govern such matters as the type and location of properties that the REIT can acquire, the maximum leverage allowed, the requirement for appropriate insurance coverage, as well as environmental policies.

The REIT has maintained its ability to properly manage both operational and financial risks. The REIT's properties are leased under long-term arrangements to a diversified base of creditworthy tenants with strong covenants and are financed with long-term fixed rate mortgages.

Other than as described above, no single tenant is critical to the REIT's ability to meet its financial obligations. The REIT's broad tenant base assists in attempting to fulfill its primary goal of maintaining a predictable cash flow. Risk is further minimized through a low vacancy rate and relatively few short to medium-term lease renewals.

AUDITORS' REPORT

To the Unitholders of H&R Real Estate Investment Trust

We have audited the consolidated balance sheets of H&R Real Estate Investment Trust as at December 31, 2003 and 2002 and the consolidated statements of earnings, unitholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Trust's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Trust as at December 31, 2003 and 2002 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants
Toronto, Canada
February 10, 2004

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The accompanying consolidated financial statements and information included in this Annual Report have been prepared by the management of H&R Real Estate Investment Trust which is responsible for their consistency, integrity and objectivity. The Trust maintains appropriate systems of internal control, policies and procedures to ensure that its reporting practices and accounting and administrative procedures are consistent, efficient and of a high quality.

KPMG LLP, the independent auditor, is responsible for auditing the consolidated financial statements and giving an opinion thereon.

The consolidated financial statements have been reviewed and approved by the Board of Trustees and the Audit Committee. This Committee meets regularly with management and the auditors who have full and free access to the Committee.

Thomas J. Hofstedter
President and Chief Executive Officer

Eric Cohen
Chief Financial Officer

CONSOLIDATED BALANCE SHEETS

(In thousands of dollars)

December 31	2003	2002
ASSETS		
Income properties (note 3)	$ 2,510,780	$ 1,922,200
Mortgages receivable (note 4)	91,744	60,079
Other assets (note 5)	79,263	68,615
	$ 2,681,787	$ 2,050,894
LIABILITIES AND UNITHOLDERS' EQUITY		
Liabilities:		
Mortgages payable (note 7)	$ 1,614,994	$ 1,239,224
Bank indebtedness (note 8)	56,281	1,280
Accounts payable	42,347	42,742
	1,713,622	1,283,246
Unitholders' equity:		
86,198,168 units (2002 – 70,910,818) (note 9(a))	979,573	767,484
Cumulative foreign currency translation adjustment	(11,408)	164
	968,165	767,648
Contingencies (note 18)		
	$ 2,681,787	$ 2,050,894

See accompanying Notes to Consolidated Financial Statements.

Approved by the trustees:

E Gilbert

Edward Gilbert
Trustee

Ronald C. Rutman
Trustee

CONSOLIDATED STATEMENTS OF EARNINGS

(In thousands of dollars, except per unit amounts)

Year ended December 31	2003	2002
Operating revenue:		
Rentals from income properties	$ 321,644	$ 288,511
Mortgage interest and other income	12,229	7,989
	333,873	296,500
Operating expenses:		
Property operating costs	113,561	109,398
Mortgage and other interest (note 16)	101,117	79,251
Depreciation of income properties	19,585	15,395
Amortization of deferred expenses	4,214	4,062
	238,477	208,106
Operating income from properties	$ 95,396	$ 88,394
Trust expenses	4,843	4,372
Net earnings	$ 90,553	$ 84,022
Basic net earnings per unit (notes 10 and 11)	$ 1.21	$ 1.20
Diluted net earnings per unit (notes 10 and 11)	$ 1.20	$ 1.19

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF UNITHOLDERS' EQUITY

(In thousands of dollars)

Year ended December 31	2003	2002
Unitholders' equity, beginning of year	$ 767,484	$ 754,737
Proceeds from issuance of units	219,554	13,164
Issue costs	(5,519)	(121)
Net earnings	90,553	84,022
Distributions to unitholders	(92,499)	(84,318)
Unitholders' equity, end of year	$ 979,573	$ 767,484

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands of dollars)

Year ended December 31	2003	2002
Cash provided by (used in):		
Operations:		
Net earnings	$ 90,553	$ 84,022
Items not affecting cash:		
Depreciation	19,585	15,395
Amortization of deferred leasing costs	3,445	3,548
Gain on sale of income properties	(4,365)	(1,405)
Funds from operations	109,218	101,560
Amortization of deferred financing costs	769	514
Changes in other non-cash operating items (note 12)	(8,346)	(13,814)
	101,641	88,260
Financing:		
Bank indebtedness	55,001	(973)
Mortgages payable:		
Acquisitions	160,684	382,168
Repayments	(36,149)	(30,652)
Proceeds from issuance of units, net	214,035	13,043
Distributions to unitholders	(92,499)	(84,318)
	301,072	279,268
Investments:		
Income properties:		
Proceeds on disposition of income properties	29,227	5,146
Acquisitions	(387,416)	(379,514)
Mortgages receivable	(35,191)	(7,283)
	(393,380)	(381,651)
Increase (decrease) in cash and cash equivalents	9,333	(14,123)
Cash and cash equivalents, beginning of year	10,208	24,331
Cash and cash equivalents, end of year (note 5)	$ 19,541	$ 10,208
Supplemental cash flow information:		
Interest paid	99,919	78,857
Supplemental disclosure of non-cash investing activities:		
Acquisitions of income properties through assumption of mortgages payable	281,052	175,280
Acquisitions of income properties through repayment of mortgages receivable	6,676	42,760
Mortgages payable assumed by purchasers on disposition of income properties	11,054	30,983
Mortgages receivable granted to purchasers on disposition of income properties	3,150	14,981

See accompanying Notes to Consolidated Financial Statements.

Years ended December 31, 2003 and 2002

H&R Real Estate Investment Trust (the "Trust") is an unincorporated trust with each unitholder participating pro rata in distributions of income and, in the event of termination of the Trust, participating pro rata in the net assets remaining after satisfaction of all liabilities.

1. SIGNIFICANT ACCOUNTING POLICIES:

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and with the recommendations of the Canadian Institute of Public and Private Real Estate Companies and reflect the following policies:

(a) Income properties:
Income properties are recorded at the lower of cost less accumulated depreciation and net recoverable amount. Depreciation of buildings is recorded on the 5% sinking fund basis to fully amortize the cost of buildings over 40 years. Intangibles resulting from in-place leases have been included in the buildings balance and are amortized over the related lease terms.

(b) Deferred expenses:
Leasing costs, such as commissions and other tenant inducements, are deferred and amortized on a straight line basis over the terms of the related leases. Mortgage financing costs are deferred and amortized over the terms of the related debt.

(c) Accrued rent receivable:
Certain leases call for rental payments that vary significantly over their term. The Trust records the rental revenue from these leases on a straight line basis, resulting in accruals for rent that are not billable or due until future years. These amounts are recorded as accrued rent receivable.

(d) Co-ownerships:
The Trust carries out a portion of its activities through co-ownership agreements and records its proportionate share of assets, liabilities, revenue, expenses and cash flows of all co-ownerships in which it participates.

(e) Income taxes:
Pursuant to the terms of its Declaration of Trust, the Trust intends to distribute its income for income tax purposes each year to such an extent that it will not be liable for income taxes under Part 1 of the *Income Tax Act (Canada)*. Therefore, no provision for income taxes is required.

(f) Unit option plan:
The Trust has an option plan available for officers, employees and certain trustees as disclosed in note 9(b). No compensation expense is recorded at the time the options are issued. Any consideration paid by option holders on exercise of unit options is credited to unitholders' equity.

(g) Cash and cash equivalents:
Included in cash and cash equivalents are short-term investments which have maturities of three months or less at the date of acquisition.

(h) Use of estimates:
The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of the assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the year. Actual results could differ from those estimates.

(i) Foreign currency translation:
The Trust accounts for its investments in the United States ("foreign operations") as self-sustaining operations. Assets and liabilities of foreign operations are translated into Canadian dollars at the exchange rate in effect at the balance sheet date, and revenue and expenses are translated at the average exchange rate for the year. The foreign currency translation adjustment is recorded as a separate component of unitholders' equity until there is a disposition of the Trust's investment in the foreign operations.

2. CHANGE IN ACCOUNTING POLICY – ACCOUNTING OF INCOME PROPERTIES:

For transactions initiated on or after September 12, 2003, the Trust has adopted the EIC Abstract EIC-140, "Accounting for Operating Leases Acquired in Either an Asset Acquisition or a Business Combination." This standard requires, that where an enterprise acquires real estate in either an asset acquisition or a business combination, a portion of the purchase price should be allocated to the in-place operating leases acquired in connection with the real estate property.

This accounting policy has been applied to two acquisitions initiated after September 12, 2003. Of the total purchase price of $51,940, management has allocated a net intangible of $2,357 to in-place leases based on management's estimate of the fair value for these two acquisitions. This amount is included in the cost of buildings for 2003.

3. INCOME PROPERTIES:

2003	Cost	Accumulated Depreciation	Net Book Value
Land	**$ 509,308**	**$ –**	**$ 509,308**
Buildings	**2,062,486**	**61,014**	**2,001,472**
	$ 2,571,794	**$ 61,014**	**$ 2,510,780**

2002	Cost	Accumulated Depreciation	Net Book Value
Land	$ 388,070	$ –	$ 388,070
Buildings	1,576,820	42,690	1,534,130
	$ 1,964,890	$ 42,690	$ 1,922,200

4. MORTGAGES RECEIVABLE:

The mortgages receivable are secured by real property, bear interest at a weighted average rate of 9.9% (2002 – 8.8%) per annum and are repayable between 2004 and 2008. In most cases, the Trust has discretionary options to acquire interests in the properties based on predetermined criteria.

5. OTHER ASSETS:

	2003	2002
Cash and cash equivalents	**$ 19,541**	$ 10,208
Deferred expenses (note 6)	**29,730**	28,859
Prepaid expenses and sundry assets	**11,788**	11,504
Accrued rent receivable	**12,498**	10,913
Accounts receivable	**5,706**	7,131
	$ 79,263	$ 68,615

6. DEFERRED EXPENSES:

2003	Cost	Accumulated Amortization	Net Book Value
Leasing	**$ 30,172**	**$ 10,289**	**$ 19,883**
Financing	**11,575**	**1,728**	**9,847**
	$ 41,747	**$ 12,017**	**$ 29,730**

2002	Cost	Accumulated Amortization	Net Book Value
Leasing	$ 28,400	$ 7,341	$ 21,059
Financing	8,818	1,018	7,800
	$ 37,218	$ 8,359	$ 28,859

7. MORTGAGES PAYABLE:

The mortgages payable are secured by income properties, bear fixed interest with a weighted average year-end rate of 7.0% (2002 – 7.4%) per annum and mature between 2004 and 2026. Included in mortgages payable at December 31, 2003 are US $276,547 (Cdn $359,511), (2002 – US $51,649 (Cdn $81,606)). Future principal payments are as follows:

Year ending December 31:		
2004	$	71,885
2005		67,895
2006		73,142
2007		89,464
2008		126,495
Thereafter		1,186,113
	$	1,614,994

8. BANK INDEBTEDNESS:

The Canadian dollar bank indebtedness bears interest at rates approximating the prime rate of a Canadian chartered bank. At December 31, 2003, the Canadian prime interest rate was 4.50% (2002 – 4.50%) per annum. Included in bank indebtedness is US $42,988 (Cdn $55,884) at December 31, 2003 (2002 – US $107 (Cdn $170)). The United States dollar bank indebtedness bears interest at LIBOR rates. The bank indebtedness is secured by fixed charges over certain income properties and is due on demand.

9. UNITHOLDERS' EQUITY:

The beneficial interests in the Trust are represented by a single class of units which are unlimited in number. Each unit carries a single vote at any meeting of unitholders and carries the right to participate pro rata in any distributions. H&R Developments and certain others, who are co-owners with the Trust in certain properties, have the right and the obligation to exchange their interest in the properties, before December 23, 2036, for an aggregate of 5,749,585 units, subject to adjustment.

(a) The following units are issued and outstanding:

As at December 31, 2001	69,771,049
Issued under the Distribution Reinvestment Plan and Direct Unit Purchase Plan	407,771
Options exercised	731,998
As at December 31, 2002	70,910,818
Issued on April 30, 2003 (at a price of $13.23 per unit)	**1,889,302**
Issued on July 31, 2003 (at a price of $13.23 per unit)	**1,889,302**
Issued on October 31, 2003 (at a price of $13.44 per unit)	**1,860,133**
Issued on December 9, 2003 (at a price of $15.50 per unit)	**8,165,000**
Issued under the Distribution Reinvestment Plan and Direct Unit Purchase Plan	**458,379**
Options exercised	**1,025,234**
As at December 31, 2003	**86,198,168**

(b) Incentive Unit Option Plan:

The Trust may grant options to its officers, employees and certain trustees for up to 5,800,000 units. The exercise price of each option approximates the market price of the Trust's units on the date of grant. The options vest at 33.3% per year from the grant date, being fully vested after three years, and expire ten years after the date of the grant.

A summary of the status of the plan as at December 31, 2003 and 2002 and the changes during the years ended on those dates are as follows:

	2003		2003	2002		2002
Options	Units		Weighted Average Exercise Price	Units		Weighted Average Exercise Price
Outstanding, beginning of year	**3,848,834**	**$**	**11.93**	3,805,832	$	11.42
Granted	**468,168**		**13.36**	775,000		13.12
Exercised	**(1,025,234)**		**11.06**	(731,998)		10.54
Outstanding, end of year	**3,291,768**	**$**	**12.40**	3,848,834	$	11.93
Options exercisable at year end	**1,875,525**	**$**	**11.96**	2,058,376	$	11.37

The options outstanding at December 31, 2003 are exercisable at varying prices ranging from $9.17 to $13.12 with a weighted average remaining life of 7.4 years. The vested options are exercisable at varying prices ranging from $9.17 to $13.12 with a weighted average remaining life of 6.6 years.

(c) Unitholders' Rights Plan:

The Trust has adopted a Unitholders' Rights Plan ("Rights Plan") effective May 20, 2003 to ensure that any takeover bid made for the units of the Trust would be made to all unitholders, treat all unitholders equally, and provide the Board of Trustees with sufficient time to consider any such offer and encourage competing bids to emerge. The Rights Plan grants unitholders the right to acquire, under certain circumstances, additional units at a 50% discount from its then current market price. The Trust, with the consent of its unitholders or rights holders, may redeem each right at a nominal price. The Rights Plan will expire at the annual meeting of unitholders in 2006, unless terminated earlier.

(d) Distribution Reinvestment Plan and Direct Unit Purchase Plan:

The Trust has a Distribution Reinvestment Plan and Direct Unit Purchase Plan for its unitholders which allows participants to reinvest their monthly cash distributions in additional trust units at an effective discount of 3% and to purchase additional trust units at an undiscounted price.

10. PER UNIT AMOUNTS:

The following table sets forth the computation of basic net earnings per unit and diluted net earnings per unit using weighted average units outstanding and adjusted weighted average units, respectively:

Year ended December 31	2003	2002
Weighted average units outstanding	**74,676,446**	70,288,657
Effect of dilutive securities:		
Incentive Unit Option Plan	**555,576**	521,822
Adjusted weighted average units and assumed conversions	**75,232,022**	70,810,479

11. STOCK-BASED COMPENSATION:

The Trust accounts for stock-based compensation and other stock-based payments to employees using the settlement method of accounting for stock-based compensation awards granted. Accordingly, no compensation cost has been recognized for its Incentive Unit Option Plan. The only stock-based compensation or payment granted by the Trust is pursuant to its Incentive Unit Option Plan.

As a result, the Trust discloses proforma amounts for options granted after January 1, 2002 to reflect the impact if the Trust had elected to adopt the fair value method of accounting for stock-based compensation. Accordingly, the Trust's net earnings and basic net earnings per unit would have decreased to the proforma amounts as indicated below for the year ended December 31.

	2003	2002
Net earnings:		
Reported	$ **90,553**	$ 84,022
Proforma	**90,155**	83,799
Net earnings per unit:		
Basic, reported	$ **1.21**	$ 1.20
Basic, proforma	$ **1.21**	$ 1.19
Diluted, reported	$ **1.20**	$ 1.19
Diluted, proforma	$ **1.20**	$ 1.18

The fair value of the stock options used to compute proforma net earnings and proforma basic net earnings per unit is the estimated fair value of each option grant on the grant date using the Black-Scholes option pricing model with the following weighted average assumptions:

Weighted Average Assumptions	2003	2002
Expected distribution yield	**9.0%**	8.6%
Expected volatility	**12.5%**	10.2%
Risk-free interest rate	**5.0%**	5.4%
Expected option life in years	**10**	10

During the year ended December 31, 2003, 468,168 options were granted (2002 – 775,000).

12. CHANGES IN OTHER NON-CASH OPERATING ITEMS:

	2003	2002
Deferred expenses	$ **(7,507)**	$ (11,868)
Prepaid expenses and sundry assets	**(284)**	(4,909)
Accrued rent receivable	**(1,585)**	(1,585)
Accounts receivable	**1,425**	(2,939)
Accounts payable	**(395)**	7,487
	$ **(8,346)**	$ (13,814)

13. RISK MANAGEMENT AND FAIR VALUES OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES:

(a) Risk management:

The Trust is exposed to interest rate risk on its borrowings. It minimizes this risk by restricting total debt to 65% of aggregate assets and by attaining long-term fixed rate debt to replace short-term floating rate borrowings. In addition, the weighted average term to maturity of long-term debt is closely matched to the remaining average lease terms.

The Trust is exposed to credit risk as an owner of real estate in that tenants may become unable to pay the contracted rents. Management mitigates this risk by carrying out appropriate credit checks and related due diligence on the significant tenants. Management has diversified the Trust's holdings so that it owns several categories of properties (office, industrial and retail) and acquires properties throughout Canada and the United States. In addition, management ensures that no tenant or related group of tenants, other than investment grade tenants, accounts for a significant portion of the cash flow. Bell Canada is the only tenant that accounts for more than 10% of the Trust's rentals from income properties.

The Trust is also exposed to credit risk as a lender on the security of real estate in the event that a borrower is unable to make the contracted payments. Such risk is mitigated through credit checks and related due diligence of the borrowers and through careful evaluation of the worth of the underlying assets.

(b) Fair values:

The fair values of the Trust's accounts receivable and other assets, bank indebtedness and accounts payable approximate their carrying amounts due to the relatively short periods to maturity of the instruments.

The fair value of the mortgages receivable approximates their carrying amounts due to relatively short periods to maturity of the instruments.

The fair value of the mortgages payable has been determined by discounting the cash flows of these financial obligations using year-end market rates for debt of similar terms and credit risks. Based on these assumptions, the fair value of mortgages payable at December 31, 2003 has been estimated at $1,632,624 (2002 – $1,271,606) compared with the carrying value of $1,614,994 (2002 – $1,239,224).

14. CO-OWNERSHIP ACTIVITIES:

These financial statements include the Trust's proportionate share of assets, liabilities, revenue, expenses and cash flows. The Trust's proportionate share of these co-ownerships ranges between 20% and 70%.

	2003	2002
Assets	$ **374,575**	$ 304,423
Liabilities	**200,372**	158,810
Revenue	**64,084**	65,025
Expenses	**48,936**	47,262
Operating income from properties	**15,148**	17,763
Cash flows provided by operations	**16,316**	16,264
Cash flows provided by (used in) financing	**42,476**	(4,177)
Cash flows used in investments	**(68,215)**	(599)

Under the terms of the co-ownership agreements, the Trust is only responsible for its proportionate share of the obligations of the co-ownerships.

15. RELATED PARTY TRANSACTIONS:

The Trust has entered into an agreement with H&R Property Management Ltd. (the "Property Manager"), a company affiliated with H&R Developments (note 9), to provide property management services concerning the properties owned by the Trust and support services in connection with the acquisition and development activities of the Trust. The current agreement is for five years expiring December 31, 2004, with three automatic five-year extensions. During the year, the Trust paid fees pursuant to this agreement of $11,479 (2002 – $10,058), of which $3,265 (2002 – $2,906) was capitalized to the cost of the income properties acquired and $2,450 (2002 – $785) was capitalized to deferred expenses.

The Trust has a mortgage payable to Batise Investments Limited, an owner of H&R Developments, in the amount of $9,604 (2002 – $11,673) bearing interest at LIBOR plus 1.5% per annum. The related mortgage interest expense was $339 (2002 – $607).

16. MORTGAGE AND OTHER INTEREST EXPENSE:

	2003	2002
Mortgage interest	$ **98,539**	$ 75,262
Interest on bank indebtedness	**2,578**	3,989
	$ **101,117**	$ 79,251

17. SEGMENT DISCLOSURES:

Geographic:
Segmented information on rentals from income properties and identifiable assets by geographic region is as follows:

Rentals from income properties from external sources	2003	2002
Canada	$ **295,481**	$ 283,071
United States	**26,163**	5,440
	$ **321,644**	$ 288,511

Income Properties	**December 31, 2003**	December 31, 2002
Canada	$ **2,022,125**	$ 1,807,984
United States	**488,655**	114,216
	$ **2,510,780**	$ 1,922,200

Revenue is attributed to countries based on location of the properties.

18. CONTINGENCIES:

In the normal course of operations, the Trust has issued letters of credit in connection with certain financings, operations and acquisitions. As at December 31, 2003, the Trust has outstanding letters of credit totalling $19,448 (2002 – $22,450), including $16,326 (2002 – $20,326) which has been pledged as security for particular mortgages payable. These letters of credit are secured in the same means as the bank indebtedness.

19. SUBSEQUENT EVENTS:

On January 15, 2004, the fourth and final $25 million tranche of 1,849,605 trust units was issued pursuant to the terms of the private placement agreement.

The Trust acquired one industrial property in Canada and one retail property in the United States totalling 230,000 square feet at a cost of approximately $19.9 million.

20. FUTURE CHANGES IN ACCOUNTING POLICIES:

Effective January 1, 2004, the Trust will change the way it accounts for stock-based compensation. It will begin to expense all compensation costs incurred in its Incentive Unit Option Plan using the fair market value method of accounting.

Effective January 1, 2004, the Trust will change its accounting policy for the depreciation of buildings. Depreciation will be changed to the straight line method from the current sinking fund method. This change will be applied prospectively.

The Trust currently records rental revenue from leases on a straight line basis for leases where the rent escalations are more than inflationary. Effective January 1, 2004, revenue from all leases will be recognized on a straight line basis over the term of the leases. This change will be applied prospectively.

CORPORATE INFORMATION

TRUSTEES AND OFFICERS

UNITHOLDER INFORMATION

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Auditors
KPMG LLP

Legal Counsel
Fraser Milner Casgrain

Investor Information
Analysts, Unitholders, and others
seeking financial data should contact:
Eric Cohen, Chief Financial Officer
(416) 635-7520

Taxability of Distributions
52% of the distributions made by the REIT to unitholders during 2003 were tax deferred. Management estimates that 50% of the distributions to be made by the REIT in 2004 will be tax deferred.

Plan Eligibility
RRSP RRIF DPSP

Stock Exchange Listing
Units of H&R REIT are listed on the Toronto Stock Exchange under the trading symbol "HR.UN".

Annual Meeting of Unitholders
June 25, 2004
1:00 p.m.
TSX Conference Centre
The Exchange Tower
130 King Street West
Toronto, ON

UNITHOLDER DISTRIBUTION REINVESTMENT PLAN AND DIRECT UNIT PURCHASE PLAN

Since January 1, 2000, H&R REIT has offered registered holders of its units resident in Canada the opportunity to participate in its Unitholder Distribution Reinvestment Plan (the "DRIP") and Direct Unit Purchase Plan.

The DRIP allows participants to have their monthly cash contributions reinvested in additional units of H&R REIT at the weighted average price of the units on the TSE for the five trading days (the "Average Market Price") immediately preceding the cash distribution date. In addition, participants will be entitled to receive an additional distribution equal to 3% of each cash distribution reinvested pursuant to the DRIP which will be reinvested in additional units.

The Direct Unit Purchase Plan allows participants to purchase additional units on a monthly basis at the Average Market Price subject to a minimum purchase of $250 per month (up to a maximum of $13,500 per year) for each participant.

For more information on the DRIP and/or the Direct Unit Purchase Plan, please contact us by email through the "Contact Us" webpage of our website or contact the plan agent: CIBC Mellon Trust Company, P.O. Box 7010, Adelaide Street Postal Station, Toronto, Ontario M5C 2W9, Tel: 416 643 5500 (or for callers outside of the 416 area code: 1 800 387 0825), Fax: 416 643 5501, Email: inquiries@cibcmellon.com.

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